SIA

Foreign Activity

An Analysis of Foreign Participation in the U.S. Securities Markets
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FOREIGN ACTIVITY IN U.S. SECURITIES

"HIGHLIGHTS"

1. While basic fundamentals for foreign investment in U.S. equities remained positive in the second quarter, there were signs of concern. As the foreign investor showed considerable caution in not joining the market rally until well into 1982, caution returned with the first indication of potential inflationary pressures. In the second quarter, foreign net purchases of U.S. equities were reduced by 53% to $1.2 billion from $2.7 billion in the first quarter. Nevertheless, at the half year mark, foreign net purchases of U.S. equities virtually matched their investment for all of 1982.

2. With the exception of the Swiss, investors from the major European countries either cut back net purchases or were net sellers of U.S. equities. Swiss investors, however, replaced British investors as the largest foreign purchasers of equities. Swiss net purchases reached $734 million, an all time quarterly high for that country.

3. Foreign investors were net buyers of $349 million of corporate bonds in the second quarter, in contrast to net sellers of $39 million in the prior quarter.

4. The pace of foreign acquisition of U.S. Treasuries slowed some 28% in the second quarter to $3.0 billion from $4.1 billion, bringing estimated foreign holdings of Treasuries to $90.6 billion at the end of June.

5. The slight moderation of U.S. interest in foreign stocks from fourth-quarter 1982 to first-quarter 1983 was short lived. In the second quarter, U.S. net purchases of foreign stocks jumped 85% to a quarterly high of $1.8 billion. For the half year, U.S. net purchases of $2.8 billion of foreign stocks surpassed the $2.1 billion annual record reached in 1980.

STRATHMORE BOND

Introduction

A variety of factors enter into investment decisions. For the foreign investor in U.S. securities, this mix includes the relative strength of the dollar, the economy, and the stock market. In the first quarter of 1983, these three factors augured well for foreign investment in U.S. equities and foreigners made substantial net purchases of $2.7 billion. However, while the basic trends of these factors remained positive over the second quarter, there were occassional signs for concern. The foreign investor quickly adopted a cautious stance, with net purchases of U.S. equities plunging to $1.2 billion.

The U.S. economic recovery picked up considerable momentum in the second quarter of 1983. After expanding at a 2.6% annual rate in the first quarter, real GNP increased at an impressive 9.7% annual rate. Although still troublesome, the unemployment rate fell from a double-digit level over the second quarter to 9.8% in June. However, while inflation remained under control, the quickened pace of the economy in the second quarter coupled with a large federal deficit gave rise to renewed fears that inflationary pressures would develop. Because of such concerns, short- and long-term real interest rates continued to be high, relative to historical experience.[1/] Indeed, interest rates took a distinct turn upward during the quarter.

While the U.S. shows the strongest signs of economic recovery, the outlook for some of the other major industrialized economies brightened considerably. Countries that already went through a recessionary adjustment process and have achieved lower inflation are beginning to recover.[2/] As with the U.S., none of these recoveries are without potential threats. Pressure remains on policy makers to stimulate economic growth and reduce unacceptable levels of unemployment. In addition, a watchful eye is being kept on U.S. interest rates, as a decisive uptrend could set off a chain reaction, whereby interest rates worldwide would increase and impede recovery.

The dollar's strength waivered somewhat in the second quarter, albeit slightly. From the end of March to the end of June, the dollar depreciated by 3% against the British pound and minimally against the Canadian dollar. Dollar gains against the other major currencies, with the exception of the mark, were not as robust as in the first quarter. The French franc lost 5% relative to the dollar and the Swiss franc fell 1% compared with 7% and 4%, respectively, in the first quarter. The yen almost held its ground.

1/ "Monetary Policy Report to the Congress," Federal Reserve Bulletin, 8/83

2/ "World Economic Outlook", Business Week, 8/22/83.

On the other hand, the German mark depreciated 5% against the dollar in contrast to only 2% in the first quarter.

On a quarterly basis, the stock market registered healthy gains. The NYSE index increased by almost 11%, the S&P 500 by 10%, and the DJI Average by 8%. From April to May, however, the market suffered a modest setback. As the foreign investor was late to participate in the market rally last year, that same caution was evident at the first sign of market weakness this year.

Foreign Activity in U.S. Equities

Gross Activity

The pace of gross activity (purchases and sales) quickened somewhat from the first to second quarter. At $37.5 billion, gross transactions increased 15% from $32.7 billion in the previous quarter. Thus, for the first six months of 1983, foreign investors accounted for an estimated 10.6% of the market value of public trading on the NYSE. All major regions upped activity, with the strongest jump stemming from Canada, 28%, followed by Europe, 16%. Gross activity averaged $35.1 billion for the first two quarters of 1983, far above 1982's quarterly average of $20.0 billion.

Net Purchases

While gross activity accelerated in the second quarter, net purchases plunged 53% to $1.2 billion from $2.7 billion. Nevertheless, foreign net purchases of U.S. equities at the half year mark, $3.9 billion, virtually matched the total for all of 1982. Precipitating the overall second-quarter decline was a 54% falloff in net purchases by European investors. With the exception of the Swiss, investors from the major European countries either cut back net purchases or were net sellers of U.S. equities. In addition, Asian investors escalated net sales by some 42% from the previous quarter. In contrast, Canadian net purchases increased minimally, while net purchases by Latin American investors jumped from $56 million to $210 million.

European Investors

After setting a record quarterly high for the region in the first three months of 1983, European investors cooled significantly to placing additional funds in U.S. equities. Net purchases plummeted from $2.4 billion in the first quarter to $1.1 billion. With the exception of Swiss investors, all major European investors cut back net purchases as the quarter progressed. Moreover, investors from the Netherlands and Belgium-Luxembourg swung to net sellers of about $145 million each. However, the major factor precipitating the sharp falloff in net purchases from Europe was the reduction by U.K. investors.

TABLE I

GROSS ACTIVITY AND NET PURCHASES
OF U.S. EQUITIES
($ Millions)

	1983 First Quarter		1983 Second Quarter	
	Gross Activity	Net Purchases	Gross Activity	Net Purchases
Europe	$19,638	$2,444	$22,687	$1,117
Belgium-Luxembourg	619	51	887	(145)
France	2,023	107	2,395	15
Germany	1,815	447	2,194	278
Netherlands	821	51	1,111	(143)
Switzerland	6,358	536	7,818	734
United Kingdom	7,150	1,194	7,691	331
Canada	3,480	298	4,463	313
Latin America	3,192	56	3,642	210
Bermuda	1,154	72	1,332	80
Netherlands Antilles	901	(65)	1,035	39
Asia	6,006	(306)	6,248	(436)
Hong Kong	659	115	809	83
Japan	920	(186)	886	(86)
"Other Asia"*	4,000	(123)	4,301	(459)
Total All Countries	$32,726	$2,650	$37,541	$1,233

Source: U.S. Treasury

* Countries included are: Bahrain, Iran, Iraq, Kuwait, Oman, Saudi Arabia, the United Arab Emirates.

U.K. investors displayed a marked enthusiasm for U.S. equities in the last quarter of 1982 and the first quarter of 1983, but little enthusiasm in the second quarter. Net purchases by U.K. investors dropped by 72% from $1.2 billion in the first quarter to $331 million. This was their lowest level of interest since the second half of 1981. Sterling enjoyed an almost uninterrupted rise against the dollar in the second quarter. Good economic news for the U.K., including lower inflation, a trade surplus, and the firming of interest rates and oil prices, fueled sterling's recovery.3/

3/ Foreign Exchange Market Trends, Irving Trust, 5/5/83.

These developments coupled with the expected victory of the Thatcher government in the elections prompted British investors to turn to their own markets.

During the second quarter, Swiss investors replaced U.K. investors as the mainstay of European investment in U.S. equities. Net purchases by Swiss investors of $734 million reached an all time quarterly high, surpassing the first quarter's record $536 million by 37%. Although prospects for recovery in Switzerland improved with stronger signs of worldwide recovery and the franc was relatively stabile, Swiss stocks lagged considerably compared with the global stock markets.

Although still substantial, net purchases by German investors fell 28% to $278 million in the second quarter from $447 million. Signs of a surer recovery are emerging for the German economy. Both GNP and industrial output are on a healthy upswing, although high unemployment remains troublesome. The German recovery is being led by the consumer which is unusual as earlier German recoveries were led by exports. German exports are up but, given the sluggishness of the European recovery, strong export demand is not likely in the near-term. The fragile nature of the German recovery and its particular vulnerability to international developments may have kept German interest in U.S. equities at a relatively high level.

Canadian Investors

The increased interest of Canadian investors in U.S. equities evidenced in the previous two quarters carried over to the second quarter of 1983. Net purchases of $313 million were made, bringing Canadian investment in the first half of the year to a substantial $611 million. The Canadian dollar performed well over the first half of 1983 in firming against the dollar, while interest rate differentials narrowed significantly. In addition, the rebound of the U.S. economy makes prospects for the Canadian recovery all the more promising. However, with industrial and technological companies to lead the recovery, Canadian investors may have sought the broader-based equity markets in the U.S.

Asian Investors

Net sales by Asian investors escalated by 42% from $306 million to $436 million. Increased net selling by the oil-exporting countries accounted for the bulk of activity, with net sales of $459 million in the second quarter compared to $123 million in the first. These investors also accelerated their net selling of U.S. corporate bonds and Treasury securities. The

decline in world oil prices and its effect on the financial position of the oil-exporting countries have precipitated a distinct change in investment patterns. In recent years, the oil-exporting countries were avid purchasers of U.S. securities. Data compiled by the Bank of England show that in the first quarter, all oil exporters ran a $7 billion current account deficit -- a marked contrast to the $4 billion surplus in 1982 and the $57 billion surplus of two years ago -- and that the liquidation of U.S. financial assets by these countries was accompanied by an even larger runoff of holdings in the U.K.4/ Japanese investors continued to make net sales of U.S. equities albeit at a more moderate pace, $86 million, than in the first quarter, $186 million. Net purchases by investors from Hong Kong were reduced by 28% to $83 million.

Foreign Activity in U.S. Corporate Bonds

The upturn in U.S. interest rates that prompted foreign investors to take a cautious approach to U.S. equities also sparked a revival of interest in U.S. corporate bonds. The path of U.S. interest rates in the second quarter was the focus of increased attention, as rapid monetary growth and the large federal deficit fueled speculation that the Federal Reserve would tighten credit. Yields on corporate bonds declined steadily in the first four months of 1983, but jumped by 75 basis points to 11.75% in May. By the end of July, corporate bond yields had risen by another 100 basis points to 12.75%.5/ Foreign investors were net buyers of $349 million of corporate bonds in the second quarter in contrast to net sellers of $39 million in the first.

The rise in U.S. rates outpaced those of foreign countries, as policymakers were reluctant to jeopardize recovery by a quick reaction to what they hoped was only a temporary spurt in U.S. rates. Interest rates in the U.K. continued to decline in the second quarter, those in Germany increased by 50 basis points from May to June, while yields in Switzerland increased minimally. The attractive returns available in the U.S. plus an appreciating dollar drew renewed attention from the foreign investor. European investors made net purchases of $540 million of corporate bonds, in contrast to net sales of $16 million in the previous quarter. Both German and Swiss investors accelerated net purchases significantly to $81 million and $393 million, repsectively, while U.K. investors swung from net

4/ Money & Capital Markets, Kidder, Peabody & Co., Inc., 7/19/83
5/ Based on data in World Financial Markets, Morgan Guaranty Trust Co.

TABLE II

GROSS ACTIVITY AND NET PURCHASES OF U.S. CORPORATE BONDS

($ Millions)

	1983 First Quarter		1983 Second Quarter	
	Gross Activity	Net Purchases	Gross Activity	Net Purchases
Europe	$3,567	$(16)	$3,640	$540
Belgium-Luxembourg	70	(10)	115	(77)
Germany	1,089	37	823	81
Switzerland	454	68	923	393
United Kingdom	1,466	(100)	1,391	133
"Other Asia"	588	(176)	914	(308)
Total All Countries	$5,141	$(39)	$5,897	$349

Source: U.S. Treasury

sellers of $100 million to net purchasers of $133 million. On the other hand, the oil-exporting countries were net sellers of $308 million, following their investment pattern towards all U.S. securities in recent quarters.

Foreign Activity In U.S. Treasury Notes And Bonds

Foreign enthusiasm for U.S. Treasury notes and bonds appears to have waned in the second quarter. However, the interest of individual investors in Treasuries may have been offset by central bank intervention to quell currency pressures. Foreign net purchases dipped some 28% from $4.1 billion to $3.0 billion in the second quarter, bringing estimated foreign holdings of Treasuries to $90.6 billion at the end of June.

Of particular note is the wide swing in transactions from Germany. Net purchases of $2.7 billion were made in the first quarter, in contrast to net sales of $16 million in the second.

The deterioration of the mark vis-a-vis the dollar accelerated during the second quarter, with the mark falling by a steep 5%. Contributing to the mark's decline were widening interest rate differentials and a number of political factors, including the potential for adverse public reaction to national security issues. The volatile trading conditions affecting the mark in foreign exchange markets was probably what led to U.S. intervention operations in late July.

TABLE III

NET FOREIGN PURCHASES AND TOTAL FOREIGN HOLDINGS OF U.S. TREASURY NOTES AND BONDS
($ Millions)

	1983 First Quarter		1983 Second Quarter	
	Net Purchases	Estimated Holdings*	Net Purchases	Estimated Holdings*
Europe	$3,533	$31,036	$1,897	$32,933
Switzerland	(43)	1,037	(167)	870
West Germany	2,709	16,273	(16)	16,257
United Kingdom	929	7,478	755	8,233
Asia	(426)	49,211	249	49,460
Japan	158	11,735	846	12,581
"Other Asia"	(625)	34,201	(919)	34,211
Total All Countries	$4,139	$87,667	$2,965	$90,632

Source: U.S. Treasury

* Treasury has discontinued publication of the estimated foreign holdings of marketable Treasury notes and bonds. Therefore, estimated holdings are based on SIA's summation of reported monthly flows.

Asian countries increased their holdings of Treasuries by $249 million, in contrast to a decrease of $426 million in the first quarter. Net purchases by Japan of $846 million helped offset to some degree the large net sales of $919 million by the oil-exporting countries. While the yen held fairly steady against the dollar over the quarter, there was reportedly increased overseas investment by Japanese institutional investors. Although Japan was seen as benefiting from declining prices for oil imports, there was the possibility of an immediate, unfavorable impact on Japan's capital account if the OPEC nations liquidated their holdings in Japanese capital markets.6/ The potential for disruption in domestic markets may have accounted for the upswing in Japanese holdings of U.S. Treasuries.

U.S. Activity in Foreign Stocks

The slight moderation of U.S. interest in foreign stocks from fourth-quarter 1982 to first-quarter 1983 was short lived. Over that period, net purchases of foreign stocks dropped 25% from $1.3 billion to $994 million. However, in the second quarter, U.S. investment in foreign stocks jumped 85% to a quarterly high of $1.8 billion. For the half year, U.S. investment in foreign stocks reached $2.8 billion, surpassing 1980's full year record of $2.1 billion. One offshoot of the increased attention of U.S. investors to overseas companies is the increased foreign offerings, particularly of Scandinavian companies, in the U.S. equity market. Some observers attribute the rash of foreign equity offerings in the U.S. to the escalating internationalization of the securities markets.7/

Increased investment was widespread, with the strongest U.S. interest shown in stocks of Canadian companies. U.S. investors upped net purchases of Canadian stocks to $214 million from $80 million in the first quarter. On an international basis, the Canadian recovery is reportedly the second strongest. The strength of the Canadian economic rebound became apparent in the second quarter. In addition, inflation dropped to under 6% on an annual basis, the balance of payments was in surplus, and the Canadian dollar held steady. These positive economic fundamentals attracted increased capital flows to the Canadian market.

6/ "Foreign Exchange Operations", Federal Reserve Bulletin, 9/83.

7/ "Guess Who's Coming to Wall Street, "Investment Dealer's Digest, 11/1/83.

U.S. net purchases of stocks of European companies escalated 69% to $961 million from $568 million in the first quarter. The bulk of this heightened activity stemmed from increased net purchases, over 100% from the prior quarter's level, of the stocks of companies located in the Netherlands and U.K. While net purchases of French stocks remain on par with the first quarter's level, around $150 million, net sales of $91 million of Swiss stocks were made. In a global comparison, the performance of the Swiss stock market has been considerably weaker than that of the other major countries. Over the first nine months of 1983, in terms of U.S. dollars, nine foreign stock markets outpaced the increase of U.S. markets, including the Netherlands, Canada and France.[8/]

TABLE IV

GROSS ACTIVITY IN AND NET PURCHASES OF FOREIGN STOCKS BY U.S. INVESTORS
($ Millions)

	1983 First Quarter		1983 Second Quarter	
	Gross Activity	Net Purchases	Gross Activity	Net Purchases
Europe	$3,188	$568	$3,935	$ 961
France	334	150	394	154
Netherlands	263	63	282	144
Switzerland	389	13	623	(91)
United Kingdom	1,507	207	1,808	448
Canada	1,182	80	1,360	214
Asia	2,479	469	2,577	679
Japan	1,979	339	2,178	554
Other	665	(123)	755	(17)
Total All Countries	$7,514	$994	$8,627	$1,837

Source: U.S. Treasury

8/ "The International Trader," Barron's, 10/10/83.

While the nine-month performance of the Japanese stock market ranked below that of the U.S., investors have shown a sustained interest in Japanese stocks since the fourth quarter of 1982. Net purchases were boosted in the second quarter by 63% to $554 million from $339 million in the prior quarter. U.S. investors are most likely focusing on Japan's export industries as world recovery looks more promising. However, the overall economic picture is far from bright. By its own standards, Japan's recent economic growth rate has been extremely low -- so low that during the first quarter of 1983, unemployment temporarily touched its highest level since the late 1950's.9/

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9/ "Japan," Financial Times Survey, 9/19/83.

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FOREIGN ACTIVITY IN U.S. SECURITIES

"HIGHLIGHTS"

1. Anticipation of inflationary pressures dampened foreign enthusiasm for investment in U.S. equities in the third quarter. Foreign net purchases dropped 19% to $977 million from $1.2 billion in the second quarter. Although interest waned as the year progressed, foreign net purchases of $4.9 billion through the first three quarters approached the record $5.8 billion set in 1981 and exceeded by 23% net purchases in 1982.

2. Net purchases of U.S. equities by Swiss investors were reduced 50% to $366 million from a quarterly high of $734 million in the second quarter. However, Swiss investors remained the largest purchases of equities as U.K. investment remained on par with that of the previous quarter, about $300 million.

3. Given an uncertain interest rate environment, foreign investors adopted a wait-and-see approach to U.S. corporate bond investment in the third quarter. Foreign net purchases fell 35% to $226 million from $349 million in the second quarter.

4. The relentless advance of the dollar against the major currencies prompted a coordinated intervention effort in the foreign exchange markets by the U.S. and most major European countries and Japan. However, while the level of European acquisition of Treasuries was dampened considerably to only $266 million, the exceptionally large net sales of $2.2 billion by the oil-exporting countries were the dominate influence on the third-quarter activity figure. Foreign holdings of U.S. Treasuries were reduced by $1.9 billion to $88.8 billion.

5. Third-quarter net purchases of foreign stocks by U.S. investors plunged 66% to $626 million from $1.8 billion in the second quarter. Nevertheless, net purchases for the first three quarters of 1983 total a record $3.5 billion, significantly surpassing the previous high of $2.1 billion set in 1980.

Introduction

Among the many factors considered by the foreign investor in U.S. securities, the performance of both the stock market and the dollar were of major influence in 1983. Impressive gains scored by the dollar and stock market in the first quarter drew $2.7 billion of foreign net purchases of U.S. equities. In the second quarter, coinciding with signs of a slowdown in the market rally and the advance of the dollar, foreign purchases were reduced to $1.2 billion. The sharp upturn of U.S. interest rates in the third quarter, while buoying the dollar, undercut the rise of the stock market and prompted continued speculation that monetary policy would be tightened. Anticipation of inflationary pressures dampened foreign enthusiasm for U.S. equities in the third quarter and net purchases dropped 19% to $997 million. Despite the waning of interest as the year progressed,the $4.9 billion of foreign net purchases of U.S. equities through the first three quarters approached the record $5.8 billion set in 1981.

The U.S. economy continued to grow at a healthy rate in the third quarter, with real GNP expanding at a 7.7% annual rate. However, fears of a resurgence of inflation dominated the financial markets, intensified by the steep climb of interest rates in July. The prime rate was boosted to 11% in August, representing the first increase in this rate in almost a year and a half. While the upturn in rates threatened the viability of the recovery, it added momentum to the dollar's strength. In late July, upward pressure on the dollar was such that the Federal Reserve intervened in the currency markets. Interest rates peaked in July, steadying the dollar and propelling the stock market to new highs in September. Nevertheless, at the end of the quarter, long-term interest rates were some 45-50 basis points higher than at the end of June.

Although there are marked variances in inflation rates, unemployment figures, and budget deficits among countries, the European recovery is generally on track. Two immediate factors contributed to the sluggish pace of the recovery: the stagnation in most export markets which has blunted external demand and domestic priorities, particularly the desire to curb inflation and reduce budget deficits, which have largely precluded policy measures stimulating domestic demands.1 Prospects for the European recovery, consequently, hinge critically on the strength of the recovery in the U.S., Canada, and Japan. The level of U.S. interest rates remains a source of concern. Any increase in U.S. rates poses a threat to both the external and internal factors affecting the strength of the European recovery.

1/ World Financial Markets, Morgan Guaranty Trust Company, 12/83.

The dollar advanced against all major currencies in July and August but lost ground in September. Nevertheless, on a quarterly basis, only the yen appreciated vis-à-vis the dollar. As in the second quarter, the dollar's strongest gains were against the French franc and German mark, 4.4% and 3.3%, respectively. The pound depreciated 2.2% against the dollar in the third quarter, while both the Canadian dollar and Swiss franc waivered minimally.

The stock market suffered a modest setback in the first two months of the third quarter and rebounded in September. On a quarterly basis, however, the rebound was not strong enough to negate the first two months' loss. Measured from end-June to end-September, the NYSE and S&P 500 indices declined by 1.2%, while the DJI Average increased minimally. Given the caution shown by the foreign investor in the second quarter when the indices registered gains ranging from 8% to 10%, the caution of foreign investors in the third quarter was not surprising as the market rally appeared to be losing steam.

Foreign Activity in U.S. Equities

Gross Activity

In the third quarter, gross activity fell 15% to $31.9 billion from $37.5 billion in the second quarter. While all major regions reduced transactions in U.S. equities, the most significant decrease, 24%, stemmed from Asia. Following in order of magnitude, European investors cut back activity by 15%, Canadian by 6%, and Latin American investors by 9%. Through the first three quarters of 1983, gross transactions by foreign investors in U.S. equities totaled about $102.1 billion, some 28% higher than gross transactions of $79.9 billion for all of 1982. Foreign investors have accounted for about 10.7% of the value of shares publicly traded on the NYSE through September 30, 1983, compared with an estimated 9.8% for full year 1982. This is particularly impressive in light of the surge in volume on the NYSE from 65.1 million daily average shares in 1982 to 85.3 million in 1983.

Net Purchases

Net purchases by foreign investors of U.S. equities dwindled by 19% in the third quarter to $997 million from $1.2 billion in the second quarter. Net selling by Asian investors dropped from $436 million in the second quarter to $53 million. Purchases by investors from the other main regions were also cut back significantly. Net purchases by Latin Americans plunged 80% to $41 million from $210 million. European and Canadian investors reduced net purchases by just under 30% to $799 million and $229 million, respectively. Although foreign interest in U.S. equities diminished as the year progressed, net purchases at $4.9 billion are almost 23% higher than 1982's total of $4.0 billion. In comparsion, net purchases in 1981 hit a record $5.8 billion.

European Investors

In the third quarter, net purchases by European investors dropped 28% to $799 million from $1.1 billion. Activity by U.K. investors remained on par with that in the second quarter, around $300 million, but this represented a dramatic departure from the marked enthusiasm of past quarters. This pattern also is evident in the activity of German investors. The most notable change in investor behavior was from Switzerland, with net purchases reduced by 50% to $366 million from an unusually large $734 million. In addition, investors from the Belgium-Luxembourg countries, France, and the Netherlands were net sellers of U.S. equities, albeit of modest amounts.

In the second quarter, Swiss net purchases reached a quarterly high of $734 million. Swiss investors surpassed U.K. investors as the most enthusiastic European purchaser of U.S. equities. However, while still maintaining the "lead", Swiss investors decreased net purchases by 50% to $366 million in the third quarter. Given the export-oriented nature of the Swiss economy, prospects for recovery have brightened considerably with the upturns in West Germany and the U.S., Switzerland's main export markets. Minimal GNP growth is projected for Switzerland in 1983, with 2% growth forecast for 1984. While the Swiss inflation rate is expected to be in line with that of the other countries, the strength of the Swiss currency could undermine an otherwise promising picture. Paralleling the slow recovery, the Swiss stock market has lagged the worldwide boom. However, with a distinct recovery in sight and the consensus belief that Swiss shares are undervalued, Swiss investors started to funnel funds to the domestic market.

U.K. investors maintained a "status quo" attitude toward investment in U.S. equities. At about $300 million in the second and third quarters of 1983, net purchases were significantly less than that of past quarters. Although the level of investment in U.S. equities in the past two quarters is comparatively low, U.S. overseas investment is reportedly running at a rapid pace. Total U.K. private overseas investment for the first half of 1983, at 5.8 billion pounds, was the highest yet -- 2 billion pounds more than total U.K. manufacturing investment over the same period.[2] The U.K. economic recovery has been consumer led, and large capital outflows continue to create concern over the international competitive position of the U.K.'s export industries. If consumer demand should slacken, the fragile nature of the U.K. recovery could be jeopardized.

2/ "Time to bring back exchange controls," Financial Times, 9/14/83.

TABLE I

GROSS ACTIVITY AND NET PURCHASES
OF U.S. EQUITIES
($ Millions)

	1983 Second Quarter		1983 Third Quarter	
	Gross Activity	Net Purchases	Gross Activity	Net Purchases
Europe	$22,687	$1,117	$19,247	$ 799
Belgium-Luxembourg	887	(145)	732	(20)
France	2,395	15	1,718	(54)
Germany	2,194	278	1,823	237
Netherlands	1,111	(143)	842	(56)
Switzerland	7,818	734	6,190	366
United Kingdom	7,691	331	7,314	300
Canada	4,463	313	4,217	229
Latin America	3,642	210	3,319	41
Bermuda	1,332	80	1,183	17
Netherlands Antilles	1,035	39	1,112	(52)
Asia	6,248	(436)	4,727	(53)
Hong Kong	809	83	824	34
Japan	886	(86)	594	212
"Other Asia" *	4,301	(459)	3,118	(326)
Total All Countries	$37,541	$1,233	$31,909	$ 997

Source: U.S. Treasury

*Countries included are: Bahrain, Iran, Iraq, Kuwait, Oman, Saudi Arabia, the United Arab Emirates.

The German recovery, the first postwar upturn led by consumers, has shown encouraging fundamentals recently. Forecasts of 0% real GNP growth in 1983, about the same as the past two years, have been revised upward based on stronger than expected growth in the second half of the year. Moreover, inflation is at a low 3% and the current account in surplus. However, the Bundesbank raised the Lombard rate by 0.5% to 5.5% in early September, the first increase in two years. While this rate increase poses a threat to exporters, it is also viewed as somewhat of a protectionist measure to stem unprecedented capital outflows. In 1982, West Germany had a net outflow of long-term capital of 16.3 billion marks and, through the first half of 1983, the figure escalated to 13.3 billion marks.[3]

3/ "A hard run to stay still," Financial Times, 9/26/83.

Most of the 1982 funds reportedly found their way into foreign bonds, but 3.2 billion marks of the 1983 outflow was placed in foreign shares, mainly U.S., compared with only 420 million marks in 1982. The German enthusiasm for high-yielding dollar - denominated assets is documented by the unusual level of net purchases of U.S. equities and corporate bonds in recent quarters. Net purchases in the third quarter totaled $237 million, down 15% from the second quarter level of $278 million. Nevertheless, through the third quarter of 1983, net purchases of U.S. equities by German investors amounted to $962 million.

French investors swung to net sellers of $54 million in the third quarter, after having made net purchases of $122 million of U.S. equities in the first half of 1983. Little interest has been seen from French investors for U.S. equities since 1981, when uncertainty surrounding the election of the Socialist government sparked large capital outflows. In 1981, French investors purchased almost $1 billion of U.S. equities, compared with about $500 million in 1980. The Socialist government, however, aware of the need to stimulate investment instituted several tax incentives to encourage domestic investment. For example, capital gains taxes were slashed to a flat 15% from 30%/60% and a parallel foreign exchange market policy was reinstated forcing French investors to pay a premium, currently about 28%, above the regular exchange rate for funds to buy foreign stocks.[4] These tax incentives helped boost the French stock market and may account for the limited interest in U.S. equities.

Canadian Investors

Net purchases by Canadian investors slid 27% to $229 million in the third quarter from $313 million. The level of net acquisition of U.S. equities by Canadian investors has been in a quarterly range of $200-$300 million, bringing the total to a significant $840 million for the first three quarters of 1983. Fundamentals for the Canadian recovery remain positive, with healthy economic growth in prospect and a firm Canadian dollar. However, Canadian rates have been quick to follow U.S. rates in the past and the jump in U.S. rates in the third quarter gave rise to questions of the future course of rates in both countries. The uncertain path of interest rates may have deterred enthusiasm for equity investment.

Asian Investors

Asian countries have been net sellers of U.S. equities through the first three quarters of 1983, with most selling activity stemming from the oil-exporting countries. Net sales of $53 million were made by the Asian countries in the third quarter, a sharp moderation from the $436 million of sales recorded in the second quarter. Unusually large net purchases by Japanese investors of $212 million offset the continued net selling by the oil-exporting

4/ "French Stocks Boom Under Socialism," Wall Street Journal, 1/10/84

countries. Given the already weak position of the yen, a surge in capital outflow to foreign markets caused the Japanese government to impose limits on overseas investment by institutions in November. However, until the third quarter, Japanese investors had shown little interest in U.S. equities, making net sales of $272 million in the first half of the year. On the other hand, the oil-exporting countries have been net sellers through the first three quarters of the year, with net sales of $908 million made. Falling oil revenues have clearly prompted a dramatic shift in the investment behavior of these countries.

Foreign Activity in U.S. Corporate Bonds

Foreign investors adopted a wait-and-see approach to U.S. corporate bonds in the third quarter. Net purchases dropped 35% to $226 million from $349 million in the second quarter. An uncertain atmosphere permeated the fixed income markets in the third quarter, with speculation rampant that the Federal Reserve would tighten monetary policy. Long-term corporate bond yields jumped from 11.75% at the end of June to 12.75% in July and drifted down to 12.25% by the end of September.[5]

Net purchases of corporate bonds by European investors were a modest $56 million in comparison with $540 million in the second quarter. However, a 29% increase in net investment by U.K. investors was responsible for the net purchase figure, with net sales from the other European countries. Returns on U.K. corporate bonds were slightly higher than those in the U.S. in the second quarter, but the third-quarter yield increase on U.S. bonds were not matched by increases in the U.K. On the other hand, returns in Germany and Switzerland climbed steadily over the quarter, which may have prompted investors from these countries to turn to domestic fixed income markets. German and Swiss investors sold $11 million and $21 million, respectively, of U.S. corporate bonds. The oil-exporting countries continue to be net sellers of corporate bonds, albeit at a much subdued pace from the previous quarter. Net sales of $59 million were made compared with $308 million in the second quarter.

The countries shown in Table II do not account for the majority of third-quarter foreign activity in corporate bonds as activity originating in these countries resulted in a wash. Transactions stemming from the other regions were the predominate force generating total net purchases of $226 million. Canadian investors purchased $34 million of corporate bonds, Latin Americans $21 million, and Japanese investors made net purchases of $127 million.

5/ Interest rate analysis throughout this report is based on data in World Financial Markets, Morgan Guaranty Trust Co.

TABLE II

GROSS ACTIVITY AND NET PURCHASES OF U.S. CORPORATE BONDS
($ Millions)

	1983 Second Quarter		1983 Third Quarter	
	Gross Activity	Net Purchases	Gross Activity	Net Purchases
Europe	$3,640	$540	$2,778	$ 56
Belgium-Luxembourg	115	(77)	131	(55)
Germany	823	81	589	(11)
Switzerland	923	393	485	(21)
United Kingdom	1,391	133	1,317	171
"Other Asia"	914	(308)	357	(59)
Total All Countries	$5,897	$349	$4,178	$226

Source: U.S. Treasury

Foreign Activity in U.S. Treasury Notes & Bonds

In late July and early August, the relentless advance of the dollar against the major currencies prompted the Federal Reserve to intervene in the foreign exchange markets to brake the dollar's rise. Although the Federal Reserve announced that the May tightening of monetary policy was intended to be only temporary, speculation of higher interest rates and stronger than expected economic growth fueled the dollar's rapid rise. The U.S. was joined by most major European countries and Japan in a coordinated effort to sell dollars and purchase other currencies. While central banks generally hold dollar reserves in Treasuries, the joint intervention resulted in a reduced level of net purchases rather than massive net sales as might be expected.

The level of European acquisitions of Treasuries was dampened to $266 million in the third quarter from $1.9 billion in the second quarter. However, the exceptionally large net sales of $2.2 billion of Treasuries by the oil-exporting countries was the predominate influence on third-quarter activity. This is consistent with the pattern of net divestiture of U.S. securities by these countries in recent quarters. The economic development of the oil-exporting countries relies heavily on government spending. With the decline in oil-production revenues, the governments of

TABLE III

NET FOREIGN PUFCHASES AND TOTAL FOREIGN HOLDINGS
OF U.S. TREASURY NOTES AND BONDS
($ Millions)

	1983 Second Quarter		1983 Third Quarter	
	Net Purchases	Estimated Holdings*	Net Purchases	Estimated Holdings*
Europe	$1,897	$32,933	$ 266	$33,199
Switzerland	(167)	870	210	1,080
West Germany	(16)	16,257	(114)	16,143
United Kingdom	755	8,233	72	8,305
Asia	249	49,460	(1,665)	47,795
Japan	846	12,581	617	13,198
"Other Asia"	(919)	33,282	(2,198)	31,084
Total All Countries	2,965	$90,632	$(1,876)	$88,756

Source: U. S. Treasury

* Treasury has discountinued publication of the estimated foreign holdings of marketable Treasury notes and bonds. Therefore, estimated holdings are based on SIA's summation of reported monthly flows.

these countries have the alternative of drawing down reserves in foreign assets in lieu of allowing economic expansion to slacken. Since receiving authorization by royal decree to do so last April, well-placed sources say the Saudi Arabian Monetary Agency had already drawn down $6-$7 billion in dollar-denominated assets by October in cooperation with the New York Federal Reserve Board.[6] In total, $1.9 billion of net sales of Treasuries by foreign investors were made in the third quarter, in contrast to net purchases of $3.0 billion in the second quarter. Thus, foreign holdings of Treasuries were reduced some 2% to an estimated $88.8 billion.

A soaring dollar and the attractive returns available on Treasuries may have induced foreign individuals to purchase Treasuries, mitigating the effect of intervention. Transactions

6/ "The Kingdom Steers a Middle Course," Institution Investor, International Edition, 12/83.

stemming from Germany resulted in net sales of $114 million of Treasuries. However, substantial reductions in net purchases are evident in the quarterly figures for the U.K. and Japan. U.K. net purchases plunged to $72 million from $755 million, and Japanese net purchases dropped to $617 million, still a material amount, from $846 million.

U.S. Investors Activity in Foreign Stocks

The uncertain path of interest rates in the third quarter cast a shadow on equity investment worldwide. Just as the enthusiasm of foreign investors waned for U.S. equity investment in the third quarter, so too did the interest of U.S. investors in foreign stocks. Third-quarter net purchases of foreign stocks by U.S. investors plunged 66% to $626 million from $1.8 billion in the second quarter. Nevertheless, net purchases for the first three quarters of 1983 total a record $3.5 billion, considerably surpassing the previous high of $2.1 billion set in 1980.

U.S. net purchases of European stocks dropped 72% to $267 million from $961 million in the second quarter. The pattern of activity by country, however, was very erratic. After making large net purchases of $304 million of French stocks in the first half of the year, U.S. investors made net sales of $15 million in the third quarter. While uncertainty about the French government's austerity program would tend to militate against foreign investment, money managers reportedly believed that the nationalization of large-capitalization companies in France changed the character of the stock market and created many investment opportunities in smaller companies.[7] Nevertheless, this selected buying of French stocks evaporated in the third quarter. Likewise, the spurt of interest in the stocks of companies located in the Netherlands diminished in the third quarter. Net purchases of $29 million were made compared to $144 million in the second quarter. Swiss stocks were the exception to the moderated U.S. interest in European stocks. U.S. investors swung to net purchasers of $122 million in the third quarter from net sellers of $91 million in the previous quarter. Although the performance of the Swiss stock market has not been as spectacular as that of the other industrialized nations, neither has its swings been as volatile. With improving economic prospects, the consensus that Swiss stocks are undervalued may have prompted increased U.S. attention.

The quick-paced recovery enjoyed by Canada in the first half of 1983, with real GNP expanding at a 7.5% annual rate, has slowed. Real growth in the fourth quarter is estimated at 3-4% reflecting decelerating money supply growth, the expiration of tax incentives encouraging consumption and slower growth in exports.[8]

7/ "Nationalization opens door for investors in French firms," Pensions & Investment Age, 9/5/83

8/ "Canada: Why the recovery fever will break," Economic Week, Citicorp, 9/26/83.

TABLE IV

GROSS ACTIVITY IN AND NET PURCHASES OF FOREIGN STOCKS BY U.S. INVESTORS
($Millions)

	1983 Second Quarter		1983 Third Quarter	
	Gross Activity	Net Purchases	Gross Activity	Net Purchases
Europe	$3,935	$ 961	$3,479	$ 267
France	394	154	407	(15)
Netherlands	282	144	357	29
Switzerland	623	(91)	416	122
United Kingdom	1,808	448	1,633	171
Canada	1,360	214	1,227	125
Asia	2,577	679	1,978	246
Japan	2,178	554	1,749	209
Other	755	(17)	482	(12)
Total All Countries	$8,627	$1,837	$7,166	$ 626

Source: U.S. Treasury

Paralleling the expected slowdown of the economy and revising of corporate earnings estimates, the sharp runup of the Toronto stock exchange hit a peak at the end of September. U.S. investors took a cautious approach to Canadian equities, reducing net purchases by 42% to $125 million in the third quarter from $214 million in the second.

U.S. investors have been bullish on Japanese stocks. Despite a substantial drop off in net purchases in the third quarter to $209 million, U.S. investment in Japanese stocks reached $1.1 billion through the first three quarters of the year. The Nikkei Dow Jones enjoyed a robust climb in 1983,and the corporate earnings picture is good. However, an expected $30 billion trade surplus which could spark protectionism by Japan's trading partners and a sluggish

domestic economy are concerns.[9] In addition, the increase in U.S. interest rates in the third quarter thwarted expectations of the long-awaited strengthening of the yen.

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9/ "Japan II," Institutional Investor, 11/83

SIA

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FOREIGN ACTIVITY IN U.S. SECURITIES

"HIGHLIGHTS"

1. Foreign investment in U.S. equities followed the course of both the dollar and stock market over the year. At $5.4 billion, foreign investment in U.S. equities in 1983 was 39% higher than in 1982 and only a shade below the record $5.8 billion set in 1981.

2. Of particular note in 1983 was the startling magnitude of foreign gross transactions in U.S. equities. Gross activity has gradually increased each year indicating a growing foreign interest in U.S. stocks. Purchases plus sales leapt 68% to $134.3 billion in 1983 from $79.9 billion in 1982. Foreign investors accounted for about 10.5% of the value of shares publicly traded on the NYSE in 1983, compared with an estimated 9.8% in 1982.

3. Until recent years, foreign interest in U.S. equities has substantially outweighed U.S. interest in foreign stocks. However, measured in net capital flows for equity investment, U.S. capital outflows offset 70% of foreign capital inflows.

4. Given a worldwide revival in equity investment in 1983, foreign net purchases of corporate bonds fell 50% to $905 million from $1.8 billion in 1982.

5. Although foreign holdings of U.S. Treasuries rose $5.8 billion to $91.1 billion at year-end 1983, the pace of acquisition is a far cry from prior years. Net purchases in 1983 plunged 66% from the 1982 level, reflecting the massive divestiture of Treasuries by the oil-exporting countries. These investors sold $5.4 billion of Treasuries in 1983, in contrast to net purchases of $7.6 billion in 1982.

6. The boom of stock markets worldwide sent U.S. investors on an unprecedented buying spree. U.S. net purchases of foreign equities reached a record-shattering $3.8 billion, about 79% more than the previous high of $2.1 billion set in 1980. In addition, gross activity in 1983 surged to $30.1 billion, twice the 1982 level.

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Introduction

A variety of factors enter into the decision to invest in foreign securites. For the foreign investor in U.S. equities, the strength of the dollar and stock market were critical in 1983. Foreign inflows paralleled the course of the dollar and stock market over the year, reaching an impressive $2.7 billion when both factors were strongest in the first quarter. Over the remaining three quarters, persistent speculation of inflationary pressures served to dampen equity investment. By the fourth quarter, foreign investment in U.S. equities had waned to $482 million. Nevertheless, at $5.4 billion in 1983, foreign enthusiasm for U.S. equities virtually matched the 1980 level and ran only a shade below the record $5.8 billion set in 1981.

The year started on an optimistic note, with a general consensus that the U.S. economic recovery was well underway. Inflation seemed tamed, although interest rates remained at relatively high levels. At the start of 1983, the prime rate was reduced to its lowest level in over two years. Positive economic fundamentals fueled the continued advance of the stock market, with the DJI Average crossing the 1100 mark for the first time. As the dollar scored gains against most major currencies, foreign investors rushed to purchase $2.7 billion of U.S. equities in the first quarter.

The U.S. recovery gained considerable momentum in the second quarter, giving rise to concern that the quick pace of the economy coupled with a large Federal deficit would spark inflationary pressures. Indeed, interest rates took a distinct turn upward. At the same time, the dollar's advance was not as robust as during the first quarter and the stock market, while continuing to gain, showed its first signs of softness. Foreign net purchases dropped 53% to $1.2 billion from the first-quarter level.

In the third quarter, fears of a resurgence of inflation dominated the financial markets, intensified by the steep climb of interest rates in July. The prime rate was boosted by 50 basis points in August, representing the first increase in 18 months. The dollar crested to new highs on rising interest rates, prompting Federal Reserve intervention in exchange markets in late July. In the wake of speculation over higher interest rates, the stock market declined minimally on a quarterly basis. Foreigners continued to cut back investment in U.S. equities, with net purchases falling to $997 million in the third quarter.

The fourth quarter was marked by heightened Congressional bickering over projected Federal deficits and what to do about them. Interest rates generally climbed to yearly peaks, and the stock market faltered in an uneven

pattern. However, preliminary fourth-quarter GNP reports indicated a slower than expected growth rate, 4.5%, somewhat soothing fears of an overheating economy. Given these developments, foreign net purchases sank to $482 million, the lowest level in 1983.

Until recent years, foreign interest in U.S. equities far outweighed U.S. interest in foreign equities. In the 1970s, foreign investors made net purchases of $21.0 billion of U.S. equities, while U.S. investors were net buyers of only $456 million in foreign stocks. However, this trend has been changing over the 1980s. To be sure, foreign interest in U.S. equities has been escalating dramatically, with net purchases averaging $5.0 billion annually in the four years 1980-83. On the other hand, U.S. investors have been showing substantial interest in foreign equities.

Should the trend of flows evident in 1983 continue, the usual favorable capital flows picture will deteriorate, thereby reducing a cushion for the unfavorable trade balance of the U.S. Foreign investors purchased $5.4 billion of U.S. equities, while U.S. investors purchased a record-shattering $3.8 billion of foreign stocks. Thus, measured in net capital flows for equity investment, U.S. capital outflows offset some 70% of capital inflows.

Exchange Rates

From year-end 1982 to year-end 1983, the dollar continued to advance against most major currencies, albeit at a pace slightly moderated from 1982. The French franc and German mark suffered the steepest depreciation, 19% and 13%, respectively. While losing ground to the dollar, the other major currencies gave up less than in 1982. The pound depreciated 10%, in contrast to 16% in 1982. Similarly, the dollar gained 8% vis-a-vis the Swiss franc, compared with 11% in 1982. The yen was the only currency to appreciate (1%) and the Canadian dollar waivered minimally in 1983. The continued appreciation of the dollar in 1983 enhanced investment in U.S.-dollar-denominated assets.

Despite a proliferation of forecasts predicting a falling dollar, the dollar advanced against all major currencies except the yen during the fourth quarter. The yen appreciated 2% during the fourth quarter against the dollar. Depreciation of the other major currencies vis-a-vis the dollar was modest, ranging from 3% for the German mark to 1% for the Canadian dollar.

Stock Market Indices

Although the fourth-quarter performance of the stock market was lackluster, overall 1983 gains were impressive. The DJI Average increased 20%, and both the NYSE and S&P 500 indices increased by over 17%. The robust market during the first half of 1983 was a major factor attracting foreign funds. As the market rally faltered in the second half of the year, foreigners' appecite for U.S. equities lessened considerably.

FOREIGN ACTIVITY IN U.S. EQUITIES

Gross Activity

Of particular note in 1983 was the startling magnitude of foreign transactions in U.S. equities. On a regional basis, the increases ranged from 88% for Latin American and Caribbean countries to 45% for Asian countries. Gross activity (purchases and sales) has increased each year, indicating a rising foreign interest in U.S. stocks. Gross transactions leapt 68% to $134.3 billion in 1983 from $79.9 billion in 1982. In the prior 5-year period, the largest jump in transactions was 71% from $43.9 billion in 1979 to $75.1 billion in 1980. The increase in foreign gross activity subsided to 6% over the 1980-82 period. In 1983, foreign investors accounted for about 10.5% of the value of shares publicly traded on the NYSE, compared with an estimated 9.8% for 1982.

Net Purchases

Net purchases of U.S. equities by foreign investors of $5.4 billion virtually match the 1980 figure, which was surpassed only by net purchases of $5.8 billion in the record-year 1981. In comparison with 1982, net purchases increased 39% from $3.9 billion. However, in 1983, over 70% or $3.9 billion of net purchases was made in the first half of the year.

With the exception of net selling by Asian countries, all major regions increased net purchases in 1983. European net purchases rose by 57% to a record $4.0 billion. Moreover, Latin American and Caribbean investors upped net purchases by 67% to $530 million. The most notable percentage increase stemmed from Canada, with 1983 net purchases of $1.2 billion representing about 5 times the 1982 level.

TABLE I

GROSS TRANSACTIONS IN AND NET PURCHASES OF U.S. EQUITIES
($ Millions)

	1982		1983	
	Gross	Net	Gross	Net
Europe	$46,674	$2,530	$ 80,511	$3,983
Belgium-Luxembourg	1,556	(62)	2,944	(106)
France	5,011	(143)	7,982	(100)
Germany	3,382	332	7,508	1,054
Netherlands	2,083	(63)	4,012	(110)
Switzerland	14,215	(579)	26,156	1,315
United Kingdom	18,704	3,118	29,352	1,810
Canada	10,034	222	16,414	1,150
Latin America	7,575	317	14,281	530
Bermuda	2,708	126	5,307	202
Netherlands Antilles	1,882	128	4,568	77
Asia	14,912	614	21,632	(405)
Hong Kong	1,711	85	3,080	164
Japan	1,992	-0-	3,257	274
"Other Asia"*	10,673	371	14,234	(808)
Total All Countries	$79,862	$3,900	$134,343	$5,423

Source: U.S. Treasury

* Countries included are: Bahrain, Iran, Iraq, Kuwait, Oman, Saudi Arabia, the United Arab Emirates

Note: For 1983, gross transaction figures by country are a summation of unrevised quarterly numbers. Total all countries and net purchase figures are based on revised data.

European Investors

European investors purchased a record $4.0 billion of U.S. equities in 1983 based mainly on activity in the first half of the year. Enthusiasm dwindled as the year progressed, and European investors actually were net sellers of $431

million in the fourth quarter. Nevertheless, 1983 net purchases were 57% higher than the 1982 level of $2.5 billion. On a yearly basis, investment behavior by country changed substantially. Three major countries remained net sellers as in 1982, the Belgium-Luxembourg countries, France, and the Netherlands. Swiss investors, however, swung from net sellers to significant net purchasers in 1983, almost surpassing British enthusiasm for U.S. equities. British investors reduced their interest in U.S. equities by 42% but still remained the largest purchasers. In addition, German investors, who have traditionally been shy of equity investment, purchased a record $1.1 billion.

British Investors

In a marked departure from the high investment levels of previous years, U.K. investors made net purchases of $1.8 billion of U.S. equities in 1983 compared to net purchases of $3.1 billion and $2.2 billion in 1982 and 1981, respectively. The U.K. economy is entering its third year of economic growth, with prospects for both exports and investment reportedly good. To keep the recovery on track, the U.K. budget is geared towards anti-inflationary measures and stimulating savings and investment. For example, U.K. policymakers are considering the abolition of a 2% share transaction tax and the removal of a surcharge on unearned income of more than 7,100 pounds.1/ Several factors could have caused the level of U.K. investment in U.S. equities to subside from previous levels: the rally of stock markets worldwide and the improving domestic corporate profit picture, coupled with the promise of lower investment taxes.

Swiss Investors

Just as the fundamentals attracting foreign capital flows to the U.S. were weakening in the latter half of 1983, those favoring Swiss-denominated investments were strengthening. While the Swiss franc continued its fall against the dollar, it rose against most major European currencies. In addition, GNP growth was turning positive after a stagnation period, inflation declined dramatically, and the current account maintained a healthy surplus. These positive fundamentals coupled with increasing rumors that Swiss shares were undervalued prompted a significant swing in the fourth quarter in Swiss investment patterns. Swiss investors purchased a record-setting $1.3 billion of U.S. equities in 1983, but were net sellers of $322 million in the fourth quarter.

1/ "Budget likely to keep inflation fight as priority", Financial Times, 3/5/84.

German Investors

After a series of stops and starts, the German economic recovery seems to be on the right track. In 1984, a 2 1/2-3% growth rate is expected, a moderate 3% inflation rate, and a 4% pickup in exports.2/ Exports, which account for 30% of West Germany's GNP, provided fuel for growth in the second half of 1983, boosted in part by the mark's position relative to the dollar. However, the languishing state of the German economy through much of the year and the strong advance of the dollar contributed to an unprecedented outflow of German capital to dollar-denominated assets. Although German net purchases of U.S. equities dropped off sharply in the fourth quarter, total net purchases of $1.1 billion in 1983 inched past the previous record of $900 million in 1981.

French Investors

The 1983 investment behavior of French investors was little changed from that of 1982. Net sales of $100 million of U.S. equities were made in 1983, compared with net sales of $143 million in 1982. The turbulence that characterized both the French franc and economy during late 1982 and the beginning of 1983 prompted the French government to establish an austerity program in March 1983. Part of this program was directed toward encouraging domestic savings and investment, while discouraging outflows of capital to foreign markets. The lack of French interest in U.S. equities may reflect these measures. By year-end 1983, there was scattered evidence that progress had been made in fostering a French recovery.

2/ "West German Economy Survey", The Economist, 2/4/84.

TABLE II

NET PURCHASES OF U.S. EQUITIES
($ Millions)

	1983 First Quarter	1983 Second Quarter	1983 Third Quarter	1983 Fourth Quarter
Europe	$2,444	$1,117	$799	$(431)
Belgium-Luxembourg	51	(145)	(20)	6
France	107	15	(54)	(166)
Germany	447	278	237	56
Netherlands	51	(143)	(56)	21
Switzerland	536	734	366	(322)
United Kingdom	1,194	331	300	(62)
Canada	298	313	229	308
Latin America	56	210	41	214
Bermuda	72	80	17	24
Netherlands Antilles	(65)	39	(52)	155
Asia	(306)	(436)	(53)	395
Hong Hong	115	83	34	(67)
Japan	(186)	(86)	212	335
"Other Asia"	(123)	(459)	(326)	106
Total All Countries	$2,650	$1,233	$997	$482

Source: U.S. Treasury

Canadian Investors

Canadian investors maintained a consistent approach to U.S. equity investment in 1983, with quarterly net purchases ranging from $229 to $313 million. For the year, net purchases totaled a substantial $1.2 billion, compared with only $222 million in 1982. The Canadian economy has made a successful comeback after an exceptionally severe recessionary period, based in large part on strong domestic and U.S. demand. The Bank of Canada has focused primarily on maintaining

price stability by monitoring the exchange rate, among other economic and financial variables, because of the rates major influence on domestic prices.3/ The Bank of Canada, therefore, did not act quickly, to follow the trend of U.S. interest rates and, especially during the second half of the year, interest rate differentials frequently favored investment in U.S.-dollar-denominated instruments. Canadian investors remained bullish on U.S. equities in the fourth quarter, upping net purchases to $308 million from $229 million in the third quarter.

Latin American & Caribbean Investors

Investment in U.S. equities in 1982 by Latin American and Caribbean investors distinctly picked up from prior years, with net purchases of $317 million made. The momentum accelerated in 1983, and these investors made net purchases of $530 million of U.S. equities. The bulk of net purchases, however, stemmed from the Caribbean countries. Purchases originating in Bermuda, the Netherlands Antilles, and the British West Indies ($115 million) account for almost 75% of total net purchases from these regions. Although the Latin American countries have made progress in instituting policies to deal with the economic adjustments necessitated by debt-servicing problems, it will be some time before these countries can attain stable economic growth.

Asian Investors

The change in the fortunes of the oil-exporting countries is easily read in the investment pattern of these countries in U.S. securities in the past two years. In contrast to net purchases of over $1 billion in both 1980 and 1981, the oil-exporting countries purchased only $371 million of U.S. equities in 1982. In 1983, with the further decline in oil-revenues coinciding with an increased need to finance the developing infrastructure, the oil-exporting countries sold $808 million of U.S. equities. Sales by these countries offset net purchases of $164 million by Hong Kong investors and $274 million by Japanese investors. For 1983, net sales by Asian countries totaled $405 million, contrasted with net purchases of $614 million in 1982.

3/ "Treasury and Federal Reserve Foreign Exchange Operations", Quarterly Review, FRBNY, Spring, 1984.

FOREIGN ACTIVITY IN U.S. CORPORATE BONDS

Given a worldwide revival in equity investment in 1983, foreign net purchases of U.S. corporate bonds fell 50% to $905 million from $1.8 billion in 1982. Over 60% of the 1983 investment was made in the second half of the year, when interest rates were on the rise along with speculation that the uptrend would continue. Although yields increased from 11.75% at year-end 1982 to 12.63% at year-end 1983, the trend of rising yields on U.S. corporate bonds was free of the marked volatility of past years. Nevertheless, the path yields would take was difficult to plot. After declining in the first four months of the year, corporate bond yields jumped to a July peak of 12.75%, then seesawed for the remainder of 1983.4/

TABLE III

GROSS TRANSACTIONS IN AND NET PURCHASES OF U.S. CORPORATE BONDS
($ Millions)

	1982		1983	
	Gross	Net	Gross	Net
Europe	$13,923	$2,347	$12,182	$ 786
Belgium-Luxembourg	400	(172)	412	(171)
Germany	4,606	1,880	3,059	227
Switzerland	1,325	195	2,295	585
United Kingdom	5,505	149	4,952	204
"Other Asia"	2,506	(600)	2,386	(765)
All Countries	$21,241	$1,809	$18,936	$ 905

Source: U.S. Treasury

4/ Interest rates analysis throughout this report is based on data in World Financial Markets, Morgan Guaranty Trust Co.

The pattern of investment in U.S. corporate bonds varied sharply on a quarterly and annual basis. European investors cut back net purchases from $2.3 billion to $786 million in 1983. Support for the high level of European net purchases in 1982 came from German investors, who purchased a significant $1.9 billion of bonds. Although net purchases by these investors were reduced to only $227 million in 1983, most of this activity was in the fourth quarter as yields in the U.S. rose and those in Germany remained steady. On the other hand, the threefold increase in net purchases by Swiss investors to $585 million is based on second-quarter activity. European investors were particularly sensitive to swings of interest rate differentials between the U.S. and other countries in 1983. The need to maintain high liquidity, however, was the driving force behind the continued net divestiture of U.S. corporate bonds by the oil-exporting countries. Net sales were stepped up in 1983 to $765 million from $600 million in 1982.

In contrast to 1982, the bulk of activity in U.S. corporate bonds is accounted for by countries not shown in Table III. Net purchases of $462 million by Japanese investors substantially mitigated the sales of the oil-exporting countries, bringing net sales for the Asian region to $148 million. In addition, Canadian investors purchased $120 million of corporate bonds, while Latin American and Caribbean investors acquired $131 million.

In the past ten years, foreign purchases of U.S. corporate bonds reached a peak of $3.5 billion in 1981 and averaged over $1 billion in most other years. Compared with the exceptional growth of foreign investment in U.S. equities, corporate bond investment has been kept artificially low by the 30% foreign withholding tax. Most foreign investors participate in the U.S. corporate bond markets via the Eurobond market. U.S. issuers represented 11% of the new issue volume in the Eurobond and foreign currency markets in 1980 and 21% of this volume in 1982. The elimination of the foreign withholding tax has gathered considerable support in recent months. Hearings are scheduled for May 1 by the House Ways and Means Committee, and the Senate Finance tax bill contains a provision to phase out the foreign withholding tax completely in 1988. Needless to say, elimination would spur greater interest by private foreign investors in U.S. fixed income instruments.

FOREIGN ACTIVITY IN U.S. TREASURY NOTES & BONDS

Estimated holdings of U.S. Treasuries by foreign investors rose by $5.8 billion to $91.1 billion at year-end 1983. Although holdings increased, the pace of acquisition

was a far cry from prior years. Net purchases in 1983 represent a 66% plunge from the 1982 level of $17.3 billion. The massive divestiture of Treasuries by the oil-exporting countries accounts for this trend. These investors sold $5.4 billion of Treasuries in 1983, in contrast to net purchases of $7.6 billion in 1982. Diminishing oil revenues and increasing domestic expenditures have forced a dramatic reversal in the investment behavior of the oil-exporting countries, which purchased more than $25 billion in Treasuries in the 1980-82 period. Many long-term investments, such as real estate and long-term governments, are being turned into short-term investments like bank deposits. Relatively liquid investments, such as stocks, are being sold and the money brought home.5/ The continuation of the net divestiture of U.S. securities by these countries could have a ripple effect on financing the deficit.

TABLE IV

NET FOREIGN PURCHASES AND TOTAL FOREIGN HOLDINGS OF U.S. TREASURY NOTES AND BONDS
($ Millions)

	1982		1983	
	Net Purch.	Estimated Holdings	Net Purch.	Estimated Holdings
Europe	$ 7,619	$29,284	$ 7,939	$35,489
Switzerland	693	1,540	38	1,118
West Germany	5,326	14,841	3,725	17,290
United Kingdom	(160)	6,549	1,975	8,524
Asia	10,872	49,543	(3,088)	46,455
Japan	797	11,578	2,333	13,910
"Other Asia"	7,575	34,829 1/	(5,397)	29,432 1/
All Countries	$17,319	$85,220	$5,836	$91,056

Source: U.S. Treasury

1/ Treasury has discontinued publication of estimated holdings of the oil-exporting countries. Figures based on last published figure plus summation of quarterly data.

5/ "Cash-Strapped Arab Governments Move to More Liquid Investments," Wall Street Journal, 3/23/84.

The level of activity by European countries and Japan gives little indication of the joint intervention of the U.S. and foreign central banks to ease dollar pressure in the foreign exchange markets. The acquisition of Treasuries by foreigners other than central banks, $4.1 billion, dominated activity in 1983, in contrast to prior years when central bank activity literally dwarfed that of all other foreign investors. Net purchases stemming from Germany dropped 20% in 1983 to a still substantial $3.7 billion, while net purchases originating in the U.K. jumped to $2.0 billion. The most significant change in investment stemmed from Japan, with net purchases soaring to $2.3 billion in 1983 from $797 million in 1982. For those foreign investors adverse to the risk inherent in equity investment, the highly liquid, riskless government market provided attractive returns as well as the opportunity to invest in an appreciating currency.

U.S. INVESTORS ACTIVITY IN FOREIGN STOCKS

While the performance of the U.S. stock market in 1983 was impressive, 12 foreign stock exchanges outpaced the U.S. in dollar terms and 15 foreign exchanges chalked up more significant gains when the comparison is based on local currencies.6/ The boom of stock markets worldwide sent U.S. investors on an unparalleled buying spree. Net purchases of foreign equities by U.S. investors reached a record-shattering $3.8 billion, about 79% more than the previous high of $2.1 billion set in 1980. Moreover, gross activity in 1983 surged to $30.1 billion, twice the 1982 level. On a quarterly basis, U.S. investors' enthusiasm for foreign stocks diminished in the second half of the year, as stock markets worldwide mirrored Wall Street's increasingly uneven performance and the uncertain path of interest rates gave rise to a cautious investment stance. U.S. investors made net purchases of only $207 million of foreign stocks in the fourth quarter, the lowest level of the year.

6/ "The International Trader", Barron's, 1/9/84.

TABLE V

GROSS TRANSACTIONS IN AND NET PURCHASES OF FOREIGN STOCKS BY U.S. INVESTORS
($ Millions)

	1982		1983	
	Gross	Net	Gross	Net
Europe	$ 6,541	$ 797	$13,453	$2,209
France	801	215	1,432	390
Netherlands	433	115	1,145	219
Switzerland	707	75	1,776	82
United Kingdom	3,618	218	6,316	1,136
Canada	2,939	(53)	4,841	333
Asia	5,121	491	9,323	1,247
Japan	4,331	479	7,930	950
Other	1,066	106	2,460	46
All Countries	$15,667	$1,341	$30,077	$3,835

Source: U.S. Treasury

Note: For 1983, gross transactions and net purchases by country are a summation of unrevised quarterly numbers. Total all countries and total net purchase figures are based on revised data.

European companies captured the major portion of U.S. investors' funds, with net purchases escalating to $2.2 billion in 1983 from $797 million in 1982. Net purchases were made of stocks of all the major European countries, but stocks of U.K. countries were in particular favor. During the year, the volatile depreciation suffered by the pound moderated and the real corporate profits' picture for British companies turned positive for the first time in three years. U.S. investors' net purchases of U.K. companies stock skyrocketed to $1.1 billion from $218 million in 1982. U.S. investors also upped net purchases of French stocks. In reportedly

selective buying, U.S. investors increased net purchases of French stocks by 81% to $390 million in 1983.

After making net sales of Canadian stocks in 1981 and 1982, U.S. investors purchased $333 million in 1983. The Canadian economy and stock market started the year on a robust note, fueled in part by the strong growth of the U.S. economy. As the year progressed, however, several developments tended to dampen enthusiasm for Canadian stocks. Shifting interest rate differentials between the U.S. and Canada more frequently began to favor dollar denominated investments. In addition, given the slackening in the pace of economic expansion in the second half of the year, earnings projections were trimmed and some analysts believed that Canadian share prices had moved too far ahead of actual performance.7/ In the fourth quarter of 1983, U.S. investors sold $86 million of Canadian stocks.

U.S. investors' interest in Japanese stocks, $950 million, was second only to U.S. interest in U.K. stocks. The 1983 investment level represents a virtual doubling of the 1982 level of $479 million. The remarkable performance of the Tokyo stock market, the persistent rumor of imminent action on the undervalued yen, and overall positive economic fundamentals overshadowed investors' fears of the adoption of protectionist measures. A survey of select issue trading on the Tokyo stock exchange revealed that foreign turnover comprised 19.4% of total turnover, just a shade below the 20.7% accounted for by Japanese commercial enterprises.8/ Nevertheless, Japanese stocks were not immune to the worldwide slowdown of equity investment as U.S. investors sold $152 million of Japanese stocks in the last quarter of 1983.

Carolyn Hildebrandt
Assistant Vice President

7/ "Going Cheap...Canada's Natural Resources," Financial Times, 2/25/84.

8/ "Japan", Financial Times Survey, 2/28/84.

TABLE VI

GROSS ACTIVITY IN AND NET PURCHASES OF FOREIGN STOCKS BY U.S. INVESTORS
($ Millions)

	1983 First Quarter	1983 Second Quarter	1983 Third Quarter	1983 Fourth Quarter
Europe	$568	$ 961	$267	$413
France	150	154	(15)	101
Netherlands	63	144	29	(17)
Switzerland	13	(91)	122	38
United Kingdom	207	448	171	310
Canada	80	214	125	(86)
Asia	469	679	246	(147)
Japan	339	554	209	(152)
Other	(123)	(17)	(12)	27
All Countries	$994	$1,837	$626	$207

Source: U.S. Treasury

SIA

Foreign Activity

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Foreign Activity in U.S. Securities

"Highlights"

1. Foreign investment in U.S. equities reached a near-record $5.4 billion in 1983. However, net purchases dwindled as the year progressed from a high of $2.7 billion in the first quarter to a low of $482 million in the fourth quarter. Foreign net purchases rose 15% to $555 million in the first quarter of 1984.

2. Foreign gross activity in U.S. equities reached a record $134.3 billion in 1983, and this heightened pace has carried through the first quarter of 1984. At $35.0 billion, transactions in the first quarter of 1984 escalated 8% from the $32.3 billion recorded in the last quarter of 1983.

3. The level of foreign investment in U.S. corporate and government bonds has been held artificially low by the 30% foreign withholding tax. With the elimination of this tax in the 1984 tax bill, we expect greater foreign interest in all U.S. fixed income instruments. Nevertheless, rising U.S. interest rates in the first quarter of 1984 sparked a 46% increase in foreign net purchases of U.S. corporate bonds to $481 million.

4. The oil-exporting countries continue to drawdown reserves held in U.S. Treasuries. Net sales by these countries of $1.3 billion of Treasuries largely offset $1.8 billion of European net purchases in the first quarter.

5. The record level of U.S. investment in foreign stocks in 1983, $3.8 billion, was based mainly on activity in the first half of the year. The cautious approach to foreign stocks shown by U.S. investors in the second half of 1983 continued in the first quarter of 1984, with net sales of $354 million made.

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Introduction

Foreign investment in U.S. equities reached a near-record $5.4 billion in 1983, with investment flows following the course of both the dollar and the stock market over the year. The build-up of concerns over an overheating U.S. economy renewing inflationary pressures, higher interest rates and runaway deficits cumulated in the fourth quarter of the year. In that quarter, despite a relatively strong dollar, foreign investment in equities dropped to the low for the year, $482 million. Many of these concerns intensified at the beginning of 1984, serving to further slow the stock market and undermine the dollar. While foreign net purchases rose 15% in the first quarter of 1984 to $555 million, there was a markedly uneven investment pattern among regions and countries. Quantitative understanding of capital flows is very limited, and the least tangible of all factors--"confidence" in a country--is probably the most important.1/

The U.S. economy expanded at a rapid clip, 9.7% annually in real terms, in the first quarter of 1984. This growth was accompanied by rising short- and long-term interest rates and a 0.5 percentage point increase in the prime rate in March. The dollar came under considerable downward pressure during much of the quarter, prompting intense speculation that the long-awaited decline of the dollar had begun. On the other hand, while economic fundamentals have turned positive for most major industrial countries, domestic tensions in some countries precipitated uncertainty.

The dollar lost ground against some major currencies during the first quarter. The French franc appreciated 4.4% against the dollar; the yen, 3.8%; and the Swiss franc, 1.4%. On the other hand, the rebounds of other major currencies were not enough to offset declines early in the quarter. The pound declined by 0.9% and the German mark, by 3.2%. The Canadian dollar weakened consistently over the quarter, giving up 2.5% by the end of March. The mixed performance of the dollar in the first quarter was temporary, as the dollar resumed its advance against all major currencies in May and June.

1/ Foreign Exchange Market Trends, Irving Trust Company, 5/3/84.

The U.S. stock market declined in every month of the first quarter. The Dow Jones Industrial Average fell by 7%, while the NYSE and S&P 500 indices retreated by 4%. Stock indices for some of the major countries recorded impressive gains, such as an 18.8% gain for Japanese stocks and an 11.6% gain for U.K. stocks. In contrast, markets in several other countries followed the downward trend of the U.S. market. West German stocks registered a 1.8% decline and Canadian stocks, a 6.2% drop.

Foreign Activity in U.S. Equities

Gross Activity

Foreign gross activity in U.S. equities reached a record $134.3 billion in 1983, or about 10.5% of the value of shares publicly traded on the NYSE. This heightened pace has carried through the first quarter of 1984. At $35.0 billion, transactions in the first quarter of 1984 escalated 8% from the $32.3 billion recorded in the last quarter of 1983. Each region increased activity, with the largest boost, 14%, stemming from Latin America. Increases from the other regions ranged from 2%-8%.

Net Purchases

After reaching $2.7 billion in the first quarter of 1983, foreign net purchases of U.S. equities declined in every quarter to a fourth-quarter low of $482 million. In the first quarter of 1984, there were some major shifts in regional investment patterns, resulting in a 15% increase in net purchases to $555 million. Net purchases by Canadian investors were doubled to $708 million. European investors swung to net purchasers of $311 million in the first quarter from net sellers of $431 million in the fourth quarter of 1983. In contrast, Asian investors were net purchasers of $395 million of equities in the fourth quarter but net sellers of $582 million in the first quarter. Latin American investors had the least dramatic quarterly change, decreasing purchases by 15% to $181 million.

TABLE I

GROSS TRANSACTIONS IN AND NET PURCHASES OF U.S. EQUITIES
($ Millions)

	1983 Fourth Quarter		1984 First Quarter	
	Gross Activity	Net Purchases	Gross Activity	Net Purchases
Europe	$18,939	$(431)	$20,403	$311
Belgium-Luxembourg	706	6	752	20
France	1,846	(166)	2,071	(173)
Germany	1,676	56	1,995	361
Netherlands	1,238	22	1,148	32
Switzerland	5,790	(322)	6,490	186
United Kingdom	7,197	(61)	7,440	(130)
Canada	4,254	308	4,342	708
Latin America & Caribbean	4,128	214	4,693	181
Bermuda	1,638	24	1,666	144
Netherlands Antilles	1,519	155	1,873	23
Asia	4,651	395	4,998	(582)
Hong Kong	788	(66)	876	(80)
Japan	857	335	571	39
"Other Asia"*	2,815	107	3,254	(604)
Total All Countries	$32,302	$482	$34,983	$555

Source: U.S. Treasury

* Countries included are: Bahrain, Iran, Iraq, Kuwait, Oman, Qatar, Saudi Arabia, the United Arab Emirates.

European Investors

With the exception of activity from Germany, Switzerland, and the U.K., activity in U.S. equities by European investors remained essentially the same on a quarterly basis. The increase in net purchases by German investors and the swing to net purchasers by Swiss investors largely offset stepped up net selling by the U.K. German and Swiss activity mainly accounted for the reversal in the European investment pattern in the

first quarter. Net purchases of U.S. equities by Europeans were $311 million in the first quarter of 1984, in contrast to net sales of $431 million in the fourth quarter of 1983.

German investors continued an enthusiastic investment approach to U.S. equities, after purchasing an all-time high of $1.1 billion in 1983. In the first quarter of 1984, German net purchases amounted to $361 million, over 6 times the $56 million purchased in the fourth quarter of 1983. Although Germany's economic picture is promising, the potential for disruption caused by the renegotiation of labor contracts dampened both the German stock market and the mark. This concern was justified as the metalworker's strike completed its first month in June. The direct and indirect effects of the strike are beginning to mount: Close to 1/2% point has been cut off German real growth for 1984, and the mark has probably lost 5-10 pfennegs against the dollar.2/ The uncertainty generated by the upcoming labor negotiations during the first quarter may have been one factor prompting German investors to return as large net purchasers of U.S. equities.

Swiss investors' activity in U.S. equities in 1983 totaled a record-setting $1.3 billion of net purchases despite large sales of $322 million in the fourth quarter. Only activity in February, when Swiss investors made net purchases of $281 million, precipitated the Swiss swing to net purchasers of $186 million in the first quarter. The heavy dependence on exports makes Switzerland's economic outlook highly susceptible to the variances of worldwide recovery. Interest rates worldwide were generally on the rise in the first quarter, playing havoc with forecasts of the strength of economic recoveries. Moreover, although Swiss stocks have been considered undervalued for some time, the Swiss stock market declined over the quarter. Reportedly, since late January, investors have been fearful -- of rising interest rates, escalating inflation, flattening earnings, the results of a restructured monetary policy and the effects of Wall Street's setback.3/

U.K. investors stepped up net sales of U.S. equities in the first quarter of 1984 to $130 million from $61 million in the last quarter of 1983. Unlike the U.S. stock market, the London market continued its impressive climb over the first quarter and the pound declined only minimally against the dollar. In 1983, U.K. investors evidenced a declining interest

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2/ Foreign Exchange Market Trends, Irving Trust Company, 6/14/84.

3/ "World Stock Market Review," Institutional Investor, 5/84.

in U.S. equities, purchasing $1.8 billion compared with $3.1 billion in 1982. Given encouraging economic fundamentals for the U.K. and government policy bent on keeping inflation under control, there was actually no compelling reason for U.K. investors to change their investment posture.

Canadian Investors

Canadian activity in U.S. equities in 1983 showed an enthusiasm not seen in recent years. With a somewhat consistent quarterly approach, Canadian investors purchased $1.2 billion of U.S. equities, $308 million of which was purchased in the fourth quarter. In the first quarter of 1984, however, net purchases jumped to $708 million. The Canadian dollar came under increasing pressure over the quarter in the wake of rising U.S. interest rates. In addition, the Canadian stock market suffered a sharp setback and speculation over the resignation announcement of Prime Minister Trudeau generated further uncertainty. Although the U.S. stock market was weakening, the U.S. investment picture was somewhat less uncertain than Canadian prospects.

Asian Investors

While Japanese investors showed only moderate interest in U.S. equities in 1983, the oil-exporting countries in response to reduced oil demand and domestic financing needs were net sellers. Thus, activity generated by these major countries in the Asian region resulted in net sales of $405 million of U.S. equities. The interest of Japanese investors in U.S. equities was seen only in the second half of 1983 and all but disappeared in the first quarter of 1984. Net purchases of $39 million were made in the first quarter, compared with $335 million in the fourth quarter. The Japanese economy is working in the Tokyo market's favor: growth is forecasted to exceed 5%, corporate profits are being revised upward, and the yen is on the rise.[4/] Nevertheless, while these factors may have dampened Japanese interest in U.S. stocks, they were not enough to interest U.S. buyers in Japanese stocks. (See page 10.)

The oil-exporting countries were net purchasers of U.S. equities in only the fourth quarter of 1983, $107 million. In first-quarter 1984, these investors resumed their net divestiture posture and sold a substantial $604 million of U.S. equities. The reversal in the fortunes of the oil-exporting countries has had a two-fold effect: on the management of foreign assets and reliance on the private sector. For Saudi

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4/ "Tokyo Stock market", the Economist, 4/7/84.

Arabia's last fiscal year, a $5.8 billion net capital inflow was recorded for the private sector. According to Saudi's minister of finance, these inflows will continue based on the distortions in exchange rates, the uncertainties in the industrialized countries, the completion of the infrastructure and the emergence of increasing local investment opportunities.5/

Foreign Activity in U.S. Corporate Bonds

The level of foreign investment in U.S. corporate and government bonds has been held artificially low by the 30% foreign withholding tax. The U.S. fixed income markets have seen little of the increasing foreign enthusiasm generated for U.S. investment in the past decade. Thus, with the elimination of the withholding tax as contained in the 1984 tax bill, we expect that private foreign investors will show a distinctly greater interest in all U.S. fixed income instruments.

TABLE II

GROSS TRANSACTIONS IN AND NET PURCHASES OF U.S. CORPORATE BONDS
($ Millions)

	1983 Fourth Quarter		1984 First Quarter	
	Gross Activity	Net Purchases	Gross Activity	Net Purchases
Europe	$2,197	$183	$2,508	$ 276
Belgium-Luxembourg	96	(48)	163	(93)
Germany	558	116	588	20
Switzerland	433	101	454	(26)
United Kingdom	778	14	977	301
Asia	1,199	56	1,109	171
Japan	464	188	457	153
"Other Asia"	527	(226)	459	(27)
Total	$4,082	$330	$4,155	$481

Source: U.S. Treasury

5/ "The New Alignment of Oil Power," Institutional Investor, International Edition, 6/84.

Nevertheless, rising U.S. interest rates in the first quarter of 1984 sparked a 46% increase in foreign net purchases of U.S. corporate bonds to $481 million from $330 million in the last quarter of 1983. U.S. yields climbed 62 basis points over the quarter, reaching 13.25% by the end of March.6/ The pattern of investment by country, however, was markedly uneven.

Net purchases of corporate bonds by Europeans jumped 51% to $276 million in the first quarter from $183 million. The increase is based mainly on large net purchases, $301 million, by U.K. investors. U.K. corporate yields declined by as much as U.S. yields rose, supporting the increased interest of U.K. investors. Although the same held true for yields on German corporate bonds, German investors cutback net purchases to $20 million from $116 million. Swiss investors also made a sharp turnaround in their investment posture, swinging to net sellers of $26 million from net purchasers of $101 million in the fourth quarter.

Japan has become an important player in the activity of the Asian region. As this region has by and large come to explain differences between European and total foreign activity, we have added the Asian region and Japan to Table II. Japanese investors were net purchasers of $188 million of corporate bonds in the fourth quarter, but reduced purchases by 19% to $153 million in the first quarter of 1984. The oil-exporting countries made net sales of $18 million of bonds in the first quarter. Activity by the oil-exporting countries in 1983 resulted in large net sales of $765 million.

Foreign Activity in U.S. Treasuries

Massive divestitures by the oil-exporting countries dominated 1983 foreign activity in U.S. Treasuries, with total foreign net acquisition plunging from $17.3 billion in 1982 to $5.8 billion in 1983. For these countries, the problem of recycling petrodollars has been replaced by the problem of financing large infrastructure projects. Thus, in 1983 Saudi Arabia alone drew down $10 billion of its $140 billion in

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6/ Interest rate analysis in this report based on data in World Financial Markets, Morgan Guaranty Trust Company of New York.

reserves and a $13 billion drawdown is projected for 1984.7/ This projection is borne out in first-quarter activity, as the oil-exporting countries made net sales of $1.3 billion of Treasuries. These sales substantially offset $1.8 billion of European net purchases, resulting in an increase of $802 million of foreign holdings of U.S. Treasuries to an estimated total of $91.9 billion.

TABLE III

NET FOREIGN PURCHASES AND TOTAL FOREIGN HOLDINGS OF U.S. TREASURY NOTES AND BONDS
($ Millions)

	1983 Full Year		1984 First Quarter	
	Net Purchases	Estimated Holdings	Net Purchases	Estimated Holdings
Europe	$7,939	$35,489	$1,787	$37,276
Switzerland	38	1,118	134	1,252
West Germany	3,725	17,290	1,546	18,836
United Kingdom	1,975	8,524	(97)	8,427
Asia	(3,088)	46,455	(618)	45,837
Japan	2,333	13,910	423	14,333
"Other Asia"*	(5,397)	29,432	(1,293)	28,139
All Countries	$5,836	$91,056	$802	$91,858

Source: U.S. Treasury

* Treasury has discountinued publication of the estimated holdings of the oil-exporting countries. Figures based on last published figure plus summation of quarterly data.

Germany remains an avid purchaser of U.S. Treasuries. Net purchases of $3.7 billion were made in 1983, and first-quarter acquisitions of $1.5 billion indicate a continuation of this

7/ "Saudi Arabia," Financial Times Survey, 4/24/84.

trend. U.S. government bond yields rose from 11.00% at year-end 1983 to 12.49% at the end of March, while German government bond yields declined by 20 basis points. Increasing yields coupled with an appreciating dollar gave German investors little reason to change their investment posture. On the other hand, U.K. investors were not attracted by changes in yields and exchange rates. Yields on U.K. government issues waivered minimally over the period, and the pound slipped by 1%. U.K. investors had shown moderate interest in Treasuries in the fourth quarter, $275 million, but swung to net sellers of $97 million in the first quarter of 1984.

U.S. Investor Activity in Foreign Stocks

International portfolio diversification took on new proportions in 1983. According to a survey of 82 international investment advisers, U.S. tax-exempt assets held by institutions internationally increased 37% during 1983 to $14.6 billion from $10.6 billion in 1982.8/ Treasury data supported the trend of increased U.S. participation in foreign markets, showing an unprecedented $3.8 billion of net purchases of foreign stocks in 1983. However, the high level of investment in foreign stocks was based mainly on activity in the first half of the year. U.S. net purchases of foreign stocks dwindled to $207 million by the fourth quarter of 1983. Given the growing threat of a resurgence of inflationary pressures, U.S. investors made net sales of $354 million of foreign stocks in the first quarter. Net sales of Canadian and Asian stocks were escalated on a quarterly basis, but it was the swing from net purchases of $413 million to net sales of $54 million of European stocks that most influenced first-quarter investment by U.S. entities internationally.

Net purchases of European stocks reached an impressive $2.2 billion in 1983, with $1.1 invested in U.K. stocks. Although the London stock exchange continued to show strength in the first quarter of 1984, U.S. investors cutback U.K. net purchases to $43 million in the first quarter of 1984 from $310 million in the last quarter of 1983. Similar caution was evident in first quarter activity in French and Swiss stocks. U.S. investors reduced net purchases of French stocks to $41 million from $101 million in the fourth quarter of 1983, and net purchases of Swiss stocks were decreased to $15 million

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8/ "International Directory," Pensions & Investment Age, 6/25/84.

from $38 million. Net sales of stocks of companies located in the Netherlands were stepped up from $17 million in the fourth quarter to $153 million. While the Netherlands struggles with one of the highest unemployment rates of the major countries, oil price declines have undercut profit expectations from oil and gas developments.

TABLE IV

GROSS ACTIVITY IN AND NET PURCHASES OF FOREIGN STOCKS BY U.S. INVESTORS
($ Millions)

	1983 Fourth Quarter		1984 First Quarter	
	Gross Activity	Net Purchases	Gross Activity	Net Purchases
Europe	$2,851	$413	$3,348	$(54)
France	297	101	311	41
Netherlands	243	(17)	371	(153)
Switzerland	348	38	339	15
United Kingdom	1,368	310	1,719	43
Canada	1,072	(86)	1,138	(130)
Asia	2,289	(147)	3,153	(235)
Japan	2,024	(152)	2,769	(193)
Other	335	27	469	65
All Countries	$6,547	$207	$8,108	$(354)

Source: U.S. Treasury

U.S. investors began to shy away from Canadian stocks in the fourth quarter of 1983, making net sales of $86 million. This trend accelerated in the first quarter, with net sales of $130 million made. The slowing pace of the Canadian economic expansion, coupled with reduced earnings estimates, halted the runup of the Canadian stock market in the latter part of 1983. Moreover, the uncertainty accompanying Prime Minister Trudeau's resignation announcement further dampened the Canadian stock market and sent the Canadian dollar to its steepest quarterly decline in over a year.

U.S. net sales of Japanese stocks increased 27% in the first quarter to $193 million from $152 million in the fourth quarter of 1983. Overall, U.S. interest in Japanese stocks in 1983, $950 million, was second only to U.S. interest in U.K. stocks. Despite a strong performance by both the yen and the Japanese stock market, U.S. investors have adopted a cautious approach to Japanese stocks. With the market at 30 times earnings and yielding slightly more than 1%, many investors are rethinking their position and cutting back on acquisitions in the Japanese market.9/

Carolyn Hildebrandt
Assistant Vice President

9/ "World Stock Market Review," Institutional Investor, 5/84.